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TAGS: ETRD EFIN ECON ENRG EINV JO
SUBJECT: JORDAN BATTLES GROWING DEFICITS; LESS THAN MEETS
THE EYE TO MOODY,S JORDAN OUTLOOK DOWNGRADE?

REF: A. AMMAN 738
¶B. 05 AMMAN 5136
¶C. 05 AMMAN 3963

Classified By: CHARGE D'AFFAIRES DANIEL RUBINSTEIN FOR REASONS 1.4 (B, D)

¶1. (SBU) SUMMARY: On January 31, global credit rating agency Moody's lowered its outlook for Jordan's sovereign rating - not the rating itself - from stable to negative. Utilizing 2003 as a benchmark, Moody's cited "ongoing deterioration" in the country's external balance of payments and fiscal account. Moody's identified three drivers of the worsening situation: dramatically higher oil prices, a sharp decline in foreign aid, and "a surge in regional private capital inflows" which has boosted domestic demand for imports. While the GoJ does not dispute Moody's calculation of the growing current account balance, it does take exception to using the atypical, Iraq war year of 2003 as a benchmark. Additionally, the government believes the current account balance fails to take into account the impact of "temporary tourist" Iraqis' spending as a current account deficit deflator. This argument may have merit, though opinions vary among knowledgeable Amman financial players about the impact Moody,s outlook shift will have on the markets. Moody's assessment that the current account deficit is being financed "through non-debt creating inflows" acknowledges the government's good work in monetary policy.

¶2. (SBU) The GoJ argues that it is taking strong steps to lower its budget deficit by cutting subsidies, increasing the value added tax for many items, and increasing the pace of privatization. While Moody's recognizes the GoJ's "bold offsetting measures," it fails to see an improved fiscal account picture. END SUMMARY.

Current Account Deficit: Moving on Up

¶3. (C) In the decision to lower its outlook for Jordan's government bonds, notes, and foreign-currency deposits, Moody's cited its concern with the "ongoing deterioration" in the current account balance over the past two years, from a surplus of 12% of GDP in 2003 to an estimated deficit of 16% of GDP in 2005. While the 16% figure is clearly high, the GoJ counters that the circumstances surrounding the Iraq war year of 2003 were exceptional (extraordinary USG aid and Saudi oil grants) and should not be used as the measuring stick. Regardless, government officials describe the $1 billion current account deficit anticipated for 2005 as totally out of their hands. In a February 5 meeting with Resident U.S. Treasury Debt Advisor, Central Bank Deputy Governor Faris Sharaf said factors such as high oil prices and lower foreign grants "are completely exogenous." When asked about Moody's concern about the influx of regional foreign capital, Minister of Finance Ziad Fariz responded

that "it's hot money, but no more unreliable than foreign aid." Hence, he implied, no less reason to shy away from it.

Central Bank: Watching Closely, Doing Its Homework
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¶4. (C) In a February 6 telcon, Acting Governor of the Central Bank of Jordan (CBJ) Mohammed Shaheen noted that in recent meetings with IMF visitors, the delegation raised the growing balance of payments deficit and inflationary pressures. The CBJ is watching macroeconomic developments closely, and proactively adopting monetary measures to deal with these issues, Shaheen underscored. He stressed that both issues were tied to exogenous factors -- inflows from newly resident Iraqis and other investment and oil price hikes. Shaheen noted that the IMF gave the CBJ a "clean bill of health." Nonetheless, the CBJ was doing its homework. The CBJ is closely monitoring indices and anticipating inflationary creep. While the CBJ raised interest rates February 5 - and would move in parallel with any future interest rate increases made by the U.S. Federal Reserve - the CBJ was also prepared to "do whatever it takes" to keep inflation in check, according to Shaheen.

Actual Current Account Deficit May be Lower than Estimated
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¶5. (C) NOTE: Post believes there may well be merit in the arguments made by prominent Jordanian economic columnist Fahed Fanek, and backed by Minister of Finance Fariz, that the close to US$1 billion classified in 2005 as "errors and omissions" is applicable to the current account deficit as a positive services account input (i.e., Iraqi "tourists" who have brought and are spending large amounts of capital in Jordan). Post has previously reported large cash inflows

into Jordan that would meet the definition of "errors and omissions" -- these inflows would not have been initially recorded until an actual transaction took place. Among these inflows were over US$100 million for use as collateral for bank letters of credit (Ref B) and cash used in real estate transactions (Ref C). When finally recorded, much of the cash that comes to Jordan in this fashion could be assumed to contribute to Jordan's reserves. If only half of the 2005 anticipated "errors and omissions" are applied as a positive input into the services account, Jordan's current account balance for 2005 falls from an anticipated 16% to 10%; still a high number by international standards but one that is much more manageable. Minister of Finance Fariz cited this example as one that led him to agree with Fanek that "Moody's made the wrong judgment due to lack of information on what is behind the figures." In Moody's defense, its statement on the negative outlook does state that it recognizes the current account deficit is being financed "through non-debt creating inflows." END NOTE.

Government Responds to Fiscal Deficit

¶6. (C) In its proposed budget for 2006, the GoJ held planned spending in line with 2005, used lower grant projections, and sought increases in revenue assumptions to narrow its fiscal deficit projections. While the process has been held up by the change in government in December, the budget is being debated seriously in Parliament, where, according to February 6 media reports, the Finance Committee is recommending an additional reduction of the deficit by cutting 0.9% through lower public expenditures. Additionally, according to MoF Secretary General Kasassabeh, the GoJ is seriously

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considering moving forward the already unpopular elimination of all oil subsidies to June of this year.

Many Market Observers & Players Disagree with Moody's Outlook
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¶7. (C) In a February 5 lunch with Deputy EconCouns, IMF

delegation head Zubair Iqbal said he found Jordan's macroeconomic fundamentals to be stable after suffering a double-headed shock last year from a drop in Overseas Direct Assistance (ODA) and in dramatically increased oil prices. Jordan had often suffered one or the other of these external shocks in its past 50 years, but never both together, he noted. All things considered, the government had done well in handling them, according to Iqbal. While growth had been above 7 percent over the past two years, he thought it would be less than 5 percent in 2006, but such high growth over several years was not to be expected. He praised Jordan for its ability to "internalize" adjustments to economic crises, which gave Jordan a relatively stable environment.

¶8. (C) World Bank technical advisor John Speakman -- who has been on the Jordan country account for 7 years -- concurred with the IMF,s Iqbal about Jordan,s adjustability, recalling Jordan's emergence from fiscal shocks after the first Gulf War as a point supporting the IMF conclusion. NOTE: According to CBJ records, for the seven years from 1990 to 1996 Jordan's current account was in deficit every year; the balance of payments deficit reached 11.7 percent of GDP in 1993. END NOTE. In this view, Jordan has likely developed a refined set of tools to monitor and adjust to macro-economic fluctuations. COMMENT: Perhaps an outstanding problem in Jordan's fiscal system - remarked upon by the IMF in a January report on fiscal transparency - is that these mechanisms are not universally incorporated into a transparent system that would or could be acknowledged by Moody's. END COMMENT

¶9. (C) In discussions with local investors February 6, Resident U.S. Treasury Debt Advisor found little preoccupation with the move by Moody's. One bank treasurer predicted there "would be little impact" in the markets. Dollar deposits in the banking system remain strong, and liquidity inflows are continuing. The Social Security Fund Director - one of the Amman Stock Exchange,s dominant players - said that since all of his investments were domestic, there would be "no impact on (his) investment policies." In fact, following the most recent 25 basis point move by the Federal Reserve, the interest rates for the 5-year JD securities "were improved", according to CBJ Deputy Governor Faris Sharaf.

¶10. (C) Taking exception to how most others interpreted the Moody's outlook, Nasha't Masri, CEO of investment fund Foursan, said the Moody's statement "is an indication that the (financial) fundamentals of the country are shaky," and that he believes there is "a medium term risk of currency devaluation." Henry Azzam, CEO of Amwal Invest, voiced

similar concern, saying the Moody's action "will negatively affect institutional investors' view of the market."

¶11. (SBU) COMMENT: While opinions vary on how accurate the Moody's assessment is and what it may lead to, no one can dispute the negative impact that increased oil prices are having on Jordan's trade deficit and fiscal account. While the GoJ's expressed desire to fast track the planned fuel subsidy elimination will spell good news for the budget, it will do little to rein in the growing current account deficit. For a country that imports virtually all of its energy needs, the current account balance will remain exorbitantly high until the price of oil falls or Jordan is able to radically alter its energy matrix in favor of domestically-available energy sources (Ref A). END COMMENT.

¶12. (U) Resident U.S. Treasury Debt Advisor contributed to this message.
Rubinstein